[COMMITTEE PRINT]

FEDERAL INCOME TAX GUIDE FOR OLDER AMERICANS

INFORMATION FOR FILING 1990 RETURNS

PREPARED BY THE

SELECT COMMITTEE ON AGING
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

REVISED EDITION

DECEMBER 1990

Comm. Pub. No. 101-786

Printed for the use of the Select Committee on Aging

This document has been printed for informational purposes only. It does not represent either findings or recommendations adopted by this Committee.

U.S. GOVERNMENT PRINTING OFFICE

36-205 WASHINGTON : 1991

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

H142-12

SELECT COMMITTEE ON AGING

EDWARD R. ROYBAL, California, *Chairman*

THOMAS J. DOWNEY, New York
HAROLD E. FORD, Tennessee
WILLIAM J. HUGHES, New Jersey
MARILYN LLOYD, Tennessee
MARY ROSE OAKAR, Ohio
THOMAS A. LUKEN, Ohio
BEVERLY B. BYRON, Maryland
HENRY A. WAXMAN, California
MIKE SYNAR, Oklahoma
BUTLER DERRICK, South Carolina
BRUCE F. VENTO, Minnesota
BARNEY FRANK, Massachusetts
TOM LANTOS, California
RON WYDEN, Oregon
GEO. W. CROCKETT, JR., Michigan
IKE SKELTON, Missouri
DENNIS M. HERTEL, Michigan
ROBERT A. BORSKI, Pennsylvania
BEN ERDREICH, Alabama
NORMAN SISISKY, Virginia
ROBERT E. WISE, JR., West Virginia
BILL RICHARDSON, New Mexico
HAROLD L. VOLKMER, Missouri
BART GORDON, Tennessee
THOMAS J. MANTON, New York
RICHARD H. STALLINGS, Idaho
JAMES McCLURE CLARKE, North Carolina
JOSEPH P. KENNEDY II, Massachusetts
LOUISE M. SLAUGHTER, New York
JAMES H. BILBRAY, Nevada
JIM JONTZ, Indiana
JERRY F. COSTELLO, Illinois
HARLEY O. STAGGERS, JR., West Virginia
FRANK PALLONE, JR., New Jersey
JOLENE UNSOELD, Washington
PETER A. DEFAZIO, Oregon
JOHN LEWIS, Georgia
WAYNE OWENS, Utah

MATTHEW J. RINALDO, New Jersey,
Ranking Minority Member
JOHN PAUL HAMMERSCHMIDT, Arkansas
RALPH REGULA, Ohio
NORMAN D. SHUMWAY, California
OLYMPIA J. SNOWE, Maine
THOMAS J. TAUKE, Iowa
JIM COURTER, New Jersey
CLAUDINE SCHNEIDER, Rhode Island
THOMAS J. RIDGE, Pennsylvania
CHRISTOPHER H. SMITH, New Jersey
SHERWOOD L. BOEHLERT, New York
JIM SAXTON, New Jersey
HELEN DELICH BENTLEY, Maryland
JIM LIGHTFOOT, Iowa
HARRIS W. FAWELL, Illinois
JAN MEYERS, Kansas
BEN BLAZ, Guam
PAUL B. HENRY, Michigan
BILL SCHUETTE, Michigan
FLOYD SPENCE, South Carolina
WILLIAM F. CLINGER, JR., Pennsylvania
CONSTANCE A. MORELLA, Maryland
PATRICIA F. SAIKI, Hawaii
JOHN EDWARD PORTER, Illinois
JOHN J. DUNCAN, JR., Tennessee
CLIFF STEARNS, Florida
CRAIG T. JAMES, Florida

RICHARD A. VELOZ, M.P.H., J.D., *Staff Director*
PAUL SCHLEGEL, *Minority Staff Director*

FOREWORD

On behalf of the Select Committee on Aging, and as a service to the Members of Congress and their constituents, we are pleased to publish again this year the very successful annual Committee information print, the **Federal Income Tax Guide for Older Americans.**

It is our experience that many older taxpayers are unfamiliar with the special provisions of the Internal Revenue Code which become available to them when they reach age 65. Many find that as they begin the transition from full-time employment to retirement, the manner in which their taxes are calculated changes dramatically because their sources of income are shifting from wages and salary to Social Security, pension and annuity benefit payments as well as personal savings and investments.

The **Tax Guide** presents, in a concise form, an introduction to basic provisions of the Tax Code benefiting older Americans. It is principally designed to address the needs of older Americans with moderate income. In addition to emphasizing issues directly affecting senior citizens, the **Tax Guide** also discusses this year's tax forms to better help taxpayers fully understand the entire process. It also identifies numerous Internal Revenue Service publications and prerecorded telephone messages which give more detailed information on the subjects discussed.

This **Tax Guide has** incorporated tax law changes affecting the 1990 tax year. Principal highlights for the 1991 tax year are summarized at the end of this document. We would particularly like to thank the Internal Revenue Service for having assisted in the preparation of the **Tax Guide.**

EDWARD R. ROYBAL,
Chairman.
MATTHEW J. RINALDO,
Ranking Minority Member.

CONTENTS

	Page
Foreword	iii
I. Assistance in Preparing Forms	1
IRS Publications	1
IRS Tax Counseling	1
IRS Tele-Tax Recordings	1
Private Tax Return Preparers	2
II. Who Must File	2
III. Filing Deadline	3
IV. Income Tax Forms	3
V. Presidential Election Campaign Fund	4
VI. Tax Form Preparation	4
Filing Status	4
Exemptions and Dependents	5
The Dependency Tests	6
Total Income	8
Adjustments to Income	12
Standard Deduction	13
Itemized Deductions	15
Tax Computation	15
Tax Credits	16
Other Taxes	17
Refund/Amount You Owe	17
VII. Preparing for Next Year	17
Estimating Tax and Withholding	17
Highlights for 1991	18
VIII. Gift and Estate Taxes	20

I. ASSISTANCE IN PREPARING FORMS

IRS Publications

The following list of free Internal Revenue Service (IRS) publications may be particularly helpful to older Americans. They may often be found at public libraries, post offices and banks. You may also order these and other publications by using the form in your tax package or by calling the IRS toll-free at 1-800-829-3676. A more complete list appears with the order form.

Publication Numbers and Titles:

1 Your Rights as a Taxpayer
17 Your Federal Income Tax
505 Tax Withholding and Estimated Tax
524 Credit for the Elderly or the Disabled
530 Tax Information for Homeowners
553 Highlights of 1990 Tax Changes
554 Tax Information for Older Americans
575 Pension and Annuity Income (Including Simplified General Rule)
721 Comprehensive Tax Guide to U.S. Civil Service Retirement Benefits
907 Tax Information for Persons with Handicaps or Disabilities
910 Guide to Free Tax Services
915 Social Security Benefits and Equivalent Railroad Retirement Benefits

IRS Tax Counseling

The Tax Counseling for the Elderly (TCE) program provides free tax assistance and return preparation to individuals age 60 and over. In addition, Volunteer Income Tax Assistance (VITA) preparers are trained to assist older, handicapped and non-English-speaking taxpayers. To find the nearest location to you, call the toll-free IRS number, 1-800-829-1040.

IRS Tele-Tax Recordings

The IRS has approximately 140 pre-recorded tapes to help answer most common Federal tax questions. If you have a push-button phone, service is available 24 hours a day, 7 days a week. Rotary (dial) service is available Monday through Friday during regular office hours. Long distance charges may apply if you call from outside the local dialing area. You should have pencil and paper ready to take notes. The following is a partial list of Tele-Tax Tapes which are of particular interest to older Americans.

Tape Numbers:

101 IRS help available
102 Tax assistance for individuals with disabilities and the hearing impaired
151 Who must file?
153 When, where, and how to file
210 Pensions and annuities
211 Pensions—The general rule and the simplified general rule
212 Lump-sum distributions
223 Social Security and equivalent Railroad Retirement benefits
251 Individual Retirement Arrangements (IRAs)
301 Should I itemize?
323 Directory of Tele-Tax topics
357 Standard deduction
401 Child care credit
403 Credit for the elderly or the disabled
452 Highlights of 1990 tax changes
465 Checklist/common errors when preparing your tax return
466 Withholding on pensions and annuities
551 Sale of your home—General
552 Sale of your home—How to report gain
553 Sale of your home—Exclusion of gain, age 55 or over

You can find the Tele-Tax telephone number for you area and a more complete listing of tapes toward the back of your tax instruction booklet.

Private Tax Return Preparers

You are responsible for the accuracy of every item entered on your return. If you pay someone to prepare the return for you and there is a mistake, the IRS will ask you, and not the preparer, to pay any back taxes, interest, and/or penalties. Therefore, you should be careful to choose someone who understands tax matters and who will prepare a complete and accurate return.

The law requires a paid preparer to sign the return and to complete the Paid Preparers Use Only section at the bottom of the form, just below your signature. You should also know how to locate this person in the future if the IRS has a question about your return.

II. WHO MUST FILE

IRS Publication 17, Chapter 1, "Filing Your Return," Tele-Tax Tape 151

Because of special tax laws, you may find that you are not required to file a Federal income tax return this year.

Generally, every person under age 65 who has wages, taxable pensions, interest and other taxable income of $5,300 or more in 1990 ($9,550 for a couple filing jointly) must file an income tax return regardless of whether any taxes are due. These figures increase to $6,100 for persons age 65 or over ($10,200 for a married couple if one is age 65 or over, $10,850 if both are age 65 or over) or to $7,500 for persons widowed in 1988 or 1989 (not remarried in

1990) who have a dependent child living with them ($8,150 if age 65 or over).

There are some situations where persons with incomes of less than $5,300 are also required to file tax returns. The most common are:

- If you are married but live apart from your spouse, or you live together but choose to file separate returns, you must file if you have income of $2,050 or more regardless of your age.
- If you can be claimed as a dependent on another taxpayer's return, you may have to file. (See instructions for the tax forms.)
- If you were self-employed and had a net profit of at least $400 in 1990, you must file in order to pay and be credited for your Social Security taxes.
- If your employer paid you in advance for any Earned Income Credit, you must file a return regardless of your total income. (See instructions for the tax forms.)
- If you had wages of $100 or more from a church or qualified church-controlled organization that is exempt from employer Social Security taxes.

Even if you are not required to file a tax return, you should do so if you want to claim a refund for any taxes withheld during 1990. If you do not file, you will not get a refund.

III. FILING DEADLINE

For 1990 income tax returns the filing deadline is midnight, Monday, April 15, 1991. Any return postmarked after April 15 may be subject to tax penalties unless an individual request for an extension of the deadline is filed by that date. All taxes, however, must be paid by April 15 even if you request an extension of time to file your return.

IV. INCOME TAX FORMS

There are three forms for filing Federal income tax returns:

- Form 1040EZ
- Form 1040A, and
- Form 1040.

If you filed tax returns in the past, a tax package which includes instructions should be mailed to you by early January. If you do not receive the correct tax return package, you can generally find the forms you need at any participating local library, post office, or bank. You can also call the IRS toll-free forms number, 1-800-829-3676, to request forms or publications.

- *Form 1040EZ* is the simplest tax return and is used only by *single individuals* who are under age 65 and not blind. You cannot claim any dependents, any adjustments to income, any itemized deductions, or any tax credits on Form 1040EZ. All your income must come from wages, salaries, tips, taxable scholarships and fellowships, and taxable interest of $400 or less. Your total income must be less than $50,000. However, most older Americans should use either Form 1040A or Form 1040.

- *Form 1040A* has been extensively revised for 1990. Many older Americans who filed Form 1040 last year may be able to file Form 1040A instead this year. Form 1040A can be used for any filing status (explained later). Your total income must be less than $50,000. In 1990, lines were added for payments received from Individual Retirement Arrangements (IRAs), pension and annuity payments, and taxable Social Security or equivalent Railroad Retirement benefits. Other income which can be reported on Form 1040A includes wages, salaries, tips, taxable scholarships and fellowships, interest, dividends, and unemployment. If you have any other type of income such as self-employment income or capital gains, you must use Form 1040. The only adjustment to income that you can take on Form 1040A is the deduction for certain contributions to an IRA. (Nondeductible IRA contributions can be reported by attaching Form 8606, *Nondeductible IRA Contributions, IRA Basis, and Nontaxable Distribution(s),* to Form 1040A). In addition to the earned income credit, the revision contains two new credit schedules: Schedule 2 for the Child and Dependent Care Expenses and Schedule 3 for the Credit for the Elderly or the Disabled. You can use Form 1040A even if estimated tax payments were made for 1990 or you take the new exclusion of Series EE savings bond (issued after 1989) interest for qualified higher education expenses.
- *Form 1040* is used by all other individuals except nonresident aliens. Form 1040 must be used if your total taxable income is $50,000 or more, or you itemize your deductions such as home mortgage interest, medical and dental expenses, job expenses, etc. Capital gains or losses can be reported only on Form 1040. If you owe self-employment taxes or alternative minimum tax, you must use Form 1040.

V. PRESIDENTIAL ELECTION CAMPAIGN FUND

You may voluntarily choose to have $1 of your taxes ($2 on a joint return) paid into this fund to help pay for Presidential election costs. Making this choice will not change the amount of tax you pay or the amount of refund you will receive.

VI. TAX FORM PREPARATION

This section describes the major sections of the 1040A and 1040 tax forms. Each item is discussed in the order that it appears on the forms. The tax form, line numbers, and relevant IRS pamphlets and Tele-Tax recordings are shown for each item.

Filing Status

FORM 1040A, LINES 1–5; FORM 1040, LINES 1–5; IRS PUBLICATION 17, CHAPTER 2, "FILING STATUS," IRS PUBLICATION 501, "EXEMPTIONS, STANDARD DEDUCTION, AND FILING INFORMATION," TELE-TAX TAPE 154

In general, your filing status depends on whether you are considered single or married on the last day of your tax year. If you file a calendar year return, your last day generally is December 31. Each

filing status has a different tax rate. If more than one filing status applies to you, choose the one that gives you the lowest tax. There are five filing statuses:

- *Single.* Generally, you are single if you were never married or you were divorced as of December 31, 1990. You are also considered single if you were legally separated, according to your state law, under a decree of divorce or a decree of separate maintenance.
- *Married Filing a Joint Return.* Generally, you are married if you were legally married as of December 31, 1990, even if you did not live with your spouse in 1990. You are also considered married if your spouse died in 1990 and you did not remarry in 1990. You may file a joint return even if only one spouse had all the income. However, both spouses must sign the tax return and both spouses are jointly and separately responsible for paying the tax.
- *Married Filing a Separate Return.* Most married couples pay less tax by filing a joint tax return. However, you can choose to file separate tax returns. After the due date of the return, you may not choose to file separate returns if you first filed a joint return for that year.
- *Head of Household.* If you were unmarried or considered unmarried as of December 31, 1990, and you provide more than half the cost of keeping up a home (that was the main home) for yourself and your unmarried child (regardless of his/her age or whether he/she was financially dependent on you) for more than 6 months, you may be eligible to file as head of household. You may also be able to file as head of household if you are entitled to claim other relatives such as your mother or father, or your married child as dependents.
- *Qualifying Widow(er) with Dependent Child.* If your spouse died in 1988 or 1989 and you remained unmarried in 1990, you may be able to continue to pay taxes at the lower joint tax rates if (1) your dependent child lived with you for the entire year, except for temporary absences; (2) you paid more than one-half of the costs of keeping up your home during all of 1990; and (3) you were entitled to file a joint return with your spouse for the year your spouse died. If you do not qualify because your spouse died before 1988 you may still be able to file as a head of household.

Exemptions and Dependents

FORM 1040A, LINES 6a–6e AND 21; Form 1040, LINES 6a–6e AND 36; IRS PUBLICATION 501, "EXEMPTIONS, STANDARD DEDUCTION, AND FILING INFORMATION," TELE-TAX TAPE 155

You can reduce your adjusted gross income by $2,050 for each exemption you are entitled to claim. You can claim yourself, your spouse, your minor children, and any other relative or member of your household who meets all five dependency tests listed below. However, you may no longer claim additional exemptions if you are age 65 or over or blind. In addition, if you are entitled to claim

another person as a dependent, that person may not claim his or her own exemption if he or she is required to file a return.

The Dependency Tests

There are five tests to determine whether someone is your dependent: relationship, married person, citizen or resident, income, and support tests. Each dependent must meet all five of the following tests:

Test 1: Relationship. Your dependent must be either your relative or someone who lived in your home as a member of your household all year. Any relationships established by marriage are not treated as ended by divorce or death. The relationship must not violate local law.

The following are considered your *relatives:*

- Your child. Your child includes your son, daughter, stepchild, adopted child; a child who lived in your home as a family member if placed with you by an authorized placement agency for legal adoption; and a foster child (any child who lived in your home as a family member for the whole year).
- Your grandchild, great-grandchild, etc.
- Your son-in-law, daughter-in-law.
- Your parent, grandparent, stepparent, parent-in-law.
- Your brother, sister, stepbrother, stepsister, brother-in-law, sister-in-law, half brother, half sister.
- If related by blood, your aunt, uncle, nephew, niece.

Test 2: Married person. Your married dependent cannot file a joint return. However, if neither the dependent nor the dependent's spouse is required to file, but they file a joint return to get a refund of all tax withheld, you may claim him or her if the other four tests are met.

Test 3: Citizen or resident. The dependent must be either a U.S. citizen or resident alien or a resident of Canada or Mexico or your adopted child who is not a U.S. citizen but who lived with you all year in a foreign country.

Test 4: Income. Generally, the dependent's gross income must be less than $2,050. Gross income does not include nontaxable income, such as welfare benefits or nontaxable Social Security benefits.

If, in 1990, your dependent was permanently and totally disabled and had income from services performed at a sheltered workshop school, that income is generally not included for purposes of the income test. For more details, get Publication 501, "Exemptions, Standard Deduction, and Filing Information."

Special rules for your dependent child: Your dependent who is your child does not have to meet this income test if either your child was under 19 at the end of 1990, or your child qualifies as a student dependent and was under age 24 at the end of 1990.

Your child is a "student dependent" if he or she:

- Was enrolled as a full-time student at a school during any five months in 1990, or

- Took a full-time, on-farm training course during any five months of 1990. (The course had to be given by a school or a state, county, or local government agency.)

To be a full-time student, the child must be enrolled in school for the number of hours or classes that the school considers to be full-time.

The school must have a regular teaching staff, a regular course of study, and a regularly enrolled body of students in attendance. School includes elementary, junior, and senior high schools; colleges, universities; and technical, trade, and mechanical schools. It does not include on-the-job training courses or correspondence schools.

Test 5: Support. The general rule is that you had to provide over half the dependent's support in 1990. If you file a joint return, support can come from either spouse. For exceptions to the support test, see the instructions for Form 1040.

Support includes food, a place to live, clothing, medical and dental care, and education. Support also includes such items as a car and furniture, but only if they are given to the dependent, or if the dependent buys them, solely for his or her own use or benefit. In figuring support, use the actual cost of these items. However, you should figure the cost of a place to live at its fair rental value. In figuring support, you must include money used by the dependent for his or her own support, even if this money was not taxable. Examples are Social Security and welfare benefits, gifts, and savings.

Support does not include such items as income and Social Security taxes, life insurance premiums, or funeral expenses.

Someone else claiming you as a dependent. If you had less than $2,050 of gross income, it may be possible for someone else to claim you as a dependent on his/her return. In this case, however, you may not claim your own exemption if you are required to file, and your standard deduction may be limited. In order for another taxpayer to claim you as a dependent, all 5 dependency tests must be met.

If more than one-half of the support is not provided by any one person, but by two or more people, then one of them—but only one—may be able to claim you as a dependent under a multiple support agreement as long as he/she contributed more than 10 percent of your support. The taxpayer who claims you as a dependent must include statements (Form 2120) from all the other contributors who provided more than 10 percent of your support saying they will not claim you as a dependent this year. These people can, if they wish, then agree among themselves to let a different contributor claim you as a dependent in any future tax year where all 5 tests are met.

As a dependent, you must file an income tax return if you are:

(1) Single and

- Your earned income was more than $3,250 ($4,050 if 65 or older or blind); or
- Your unearned income was more than $500 ($1,300 if 65 or older or blind; $2,100 if both 65 or older AND blind); or

- Your gross income was more than the total of your earned income (up to $3,250) or $500, whichever is larger; plus $800 if 65 or older or blind ($1,600 if both 65 or older AND blind).

(2) Married and

- Your gross income was at least $5 and your spouse files a separate return and itemizes deductions; or
- Your earned income was more than $2,725 ($3,375 if 65 or older or blind); or
- You have unearned income and your gross income was more than $500 ($1,150 if 65 or older or blind; $1,800 if both 65 or older AND blind); or
- Your gross income was more than the total of your earned income (up to $2,725), or $500, whichever is larger, plus $650 if 65 or older or blind ($1,300 if both 65 or older AND blind).

Total Income

FORM 1040A, LINES 7–14; FORM 1040, LINES 7–23; IRS PUBLICATION 525, "TAXABLE AND NONTAXABLE INCOME," TELE-TAX TAPES, 201–226

Generally, you must include in gross income everything you receive in payment for personal services. In addition to wages, salaries, commissions, tips and fees, this includes other forms of compensation such as fringe benefits and payments for certain expenses you incur. You must report income in the form of goods or services at the fair market value of the goods or services you received. Income of particular interest to older Americans includes certain nontaxable income, interest, dividends, gain from the sale of a main home, pensions and annuities, distributions from IRAs, Social Security and equivalent Railroad Retirement benefits, and gambling and lottery winnings.

Almost every employer or institution which pays you income is required, by January 31, to send you a Form W–2 or a Form 1099 telling you how much they paid you in 1990. However, even if you were not notified, it is still your responsibility to list all of your taxable income on your tax return.

Some of the important non-salary income sources for older Americans and their tax status are listed below:

- *Nontaxable income.* (Tele-Tax Tape 222.) Generally gifts and inheritances you receive are not taxable to you; the person making the gift/bequest already paid taxes, if any, on the income used to purchase the gift or to build the estate. However, if you later receive income such as interest, dividends, or rents from such property, that income is taxable to you. Department of Veterans Affairs payments and/or insurance proceeds paid at the death of the insured are usually tax free.
- *Dividend and interest.* Dividend and interest income is generally taxable. However, interest earned on notes or bonds issued by a State or local government may not be taxable. (Tele-Tax Tapes 203, 204.) You must show on your tax return any tax-exempt interest you received or accrued during the tax year. This is an information-reporting requirement and does not convert tax-exempt interest to taxable interest. You must report

the entire amount of your ordinary dividends as taxable income. If you fail to provide the payer of interest and dividends with your correct Social Security number or you do not include all of this income on your return, the IRS can require the payer to withhold 20 percent of future interest and dividend income as payment for taxes due (Tele-Tax Tape 463).

- *Interest exclusion for qualified U.S. savings bonds.* Beginning in 1990, all or part of the interest from certain U.S. savings bonds can be excluded from income if you pay qualified higher education expenses during the year you redeem the bonds. The bonds must have been issued after 1989 to an individual age 24 or older. Qualified higher education expenses are tuition and required fees at a college or eligible vocational school for the bonds' owner or the owner's spouse or dependent. For more information, see Publication 550, "Investment Income and Expenses."
- *Social Security benefits.* Since income taxes are not withheld from monthly Social Security checks and underwitholding may subject you to a penalty, you may want to increase tax withholding from your other income if you expect to own taxes on the benefits you received. See the section titled "Estimated Tax and Withholding," later.

Generally, you will owe taxes on some (but never more than half) of your Social Security benefits if your total income minus half of your Social Security benefits exceeds $25,000 for single and married persons who lived apart all year and do not file jointly, and $32,000 for married couples filing jointly. Married couples who lived together but file separate returns must include part of their benefits in taxable income, regardless of the amount of other income.

The Social Security Administration (SSA) is required to send every beneficiary a statement (Form SSA-1099) showing the total benefits received in 1990. If you do not receive an SSA-1099 by early February or you believe the statement to be incorrect, you can call the toll-free SSA number, 1-800-234-5772, or call IRS Tele-Tax Tape 223.

To estimate quickly whether you are likely to owe taxes on a portion of your Social Security benefits, add up all of your income from all sources, including any tax-exempt interest you may have received and one-half of your Social Security benefits.

If the total of all your income from all sources is less than $25,000 ($32,000 for married couples filing jointly), then you can be sure that none of your Social Security benefits is taxable *unless* you are married and live together but file a separate return. For example, a single retiree with $4,800 from a private pension that is fully taxable, $6,000 in part-time wages, $2,400 in interest on savings, $1,000 in interest on municipal bonds and $7,200 from Social Security benefits has a total income of $21,400 or $17,800 if only one-half of his/her benefits is included. Since the person's total income from all sources is less than $25,000, he/she can be sure that none of his/her Social Security benefits is taxable.

If the total of all your income from all sources **exceeds** $25,000 ($32,000 for married couples filing jointly), you need to check further to determine how much, if any, of your benefits will be subject to tax. One group particularly likely to owe additional taxes on their benefits is couples with one retired spouse and one spouse working. Married couples who live together but file separate returns will usually pay more taxes than if they filed jointly.

Generally, the actual Social Security benefits subject to tax is the lesser of: (a) one-half of your net Social Security benefits, or (b) one-half of the amount by which all of your non-Social Security income (modified adjusted gross income) plus one-half of your Social Security benefits exceeds $25,000 ($32,000 for married couples filing jointly).

IRS has a worksheet for calculating the exact benefits subject to tax on page 16 of the Form 1040 instruction booklet. For more complete information, see IRS Publication 915, "Social Security Benefits and Equivalent Railroad Retirement Benefits," or call Tele-Tax Tape 223, "Social Security and Equivalent Railroad Retirement benefits."

- *Railroad Retirement Benefits.* Railroad retirees may elect to have income taxes withheld from their benefits. Aiternatively, you may prefer to make quarterly estimated tax payments directly to IRS. See the section titled "Estimated Tax and Withholding," later.

  A Railroad Retirement benefit is comprised of up to four different parts. Before 1984, only the supplemental annuity was taxable. Beginning in 1984, the other three parts became taxable but each in a different way. Only the Social Security equivalent portion of tier I benefits is taxed in the same manner as Social Security benefits. Tier II benefits and the non-Social Security equivalent portion of tier I benefits are fully taxable after they exceed the retirement contributions which were deducted from earnings during the worker's career. Vested dual benefits, like the supplemental annuity, are fully taxable.

  By January 31, the Railroad Retirement Board will send each beneficiary a Form RRB-1099 documenting the amount of equivalent tier I benefits, a Form RRB-W-2P covering the other parts, and a worksheet to help determine whether the equivalent benefits are taxable. If you receive both Railroad Retirement and Social Security benefits, you should use the Railroad Retirement worksheet. More complete information can be found in IRS Publication 575, "Pension and Annuity Income (Including Simplified General Rule)."
- *Capital gains.* The 60 percent capital gain deduction is no longer allowed. You must include the full amount of your net capital gain in your income. (See IRS Publication 544, "Sales and Other Dispositions of Assets," and/or call Tele-Tax Tape 209.)
- *Pensions and annuities.* You should receive a Form W-2P or Form 1099-R showing the amount of your pension or annuity. Be sure to attach Form W-2P to your return. Your pension or annuity payments are fully taxable if you did not contribute to

the cost of your pension or annuity, or you used the 3-Year Rule and you got back tax-free your entire cost before 1990. Fully taxable pensions and annuities also include military retirement pay shown on Form W-2P and any taxable Railroad Retirement benefits shown in Box 12 of Form RRB-W-2P.

If your pension or annuity is not fully taxable and your Form W-2P does not show the taxable part, you must use the General Rule to figure the taxable part. The General Rule is explained in Publication 939, "Pension General Rule (Nonsimplified Method)." But, if your annuity starting date was after July 1, 1986, you may be able to use the Simplified General Rule as explained in Publication 575, "Pension and Annuity Income (Including Simplified General Rule)." If your pension is civil service, you should get Publication 721, "Comprehensive Tax Guide to U.S. Civil Service Retirement Benefits."

If you receive a lump-sum payment, you may be eligible to lower the taxes due on it by using Form 4972, "Tax on Lump-sum Distributions." For details, get Form 4972.

- *Individual Retirement Arrangements (IRAs).* Distributions from an IRA, whether from principal or earnings, are generally fully taxable when received. Exceptions to this general rule include rollovers and timely withdrawals of excess contributions. See Publication 590, "Individual Retirement Arrangements (IRAs)," for more information on rollovers and excess contribution withdrawals. If you have made nondeductible contributions to your IRA, you have a cost basis in your IRA. The part of any distributions representing a return of your nondeductible contributions is not taxed when distributed to you. A 10% tax in addition to the regular income tax applies to any distributions before age 59½ except in certain cases such as the death or disability of the IRA owner. Distributions must begin by April 1 of the calendar year following the year in which you become age 70½ to avoid substantial additional taxes.
- *Unemployment compensation* is fully taxable.
- *Proceeds from the sale of a home.* Special rules apply to the sale of a main home by persons age 55 or older. If you were age 55 or older on the date of the sale or exchange, and (1) you owned and lived in the house for at least three years of the five-year period ending on the date of the sale, and (2) you or your spouse have never excluded gain on the sale or exchange of a home after July 26, 1978, then you may elect to completely exclude up to $125,000 ($62,500 if you are married filing separately) of the gain from gross income, regardless of whether you buy another home. You may choose to exclude the gain only once for sales or exchanges after July 26, 1978.

  In the case of a jointly owned home, both you and your spouse will meet the age, ownership, and use tests if:

  —You hold the home either as joint tenants, tenants by the entirety, or as community property on the date of the sale or exchange;

  —You file a joint return for the tax year in which you sell the home; and

—Either of you are 55 or older on the date of the sale and has owned and lived in the property as your main home for the required time before the sale or exchange.

If the home is not jointly owned, the spouse who owns the property must meet the age, ownership, and use tests. The other spouse must join in making the choice.

If you become physically or mentally unable to care for yourself and live in a nursing home or a state-licensed facility, you will be considered to have lived in your home as your main home during your stay in the facility if you have owned and lived in your home as your main home for a total of at least one year during the five-year period. This exception applies to sales after September 30, 1988.

If you purchase (or build) and live in another main home that costs at least as much as the adjusted sales price of the old home within two years before or two years after the date of sale, your entire gain on the sale is postponed at the time of the sale or exchange. It is not necessary to use the profit from the sale of the first home as a down payment on the second home in order to postpone the tax on the gain from the sale.

If you sell your main home and purchase another main home for an amount less than the adjusted sales price of the home you sold, you should carefully consider whether it will be more advantageous to use the exclusion now or when you sell the second home. If the gain on the first home is partially postponed due to the purchase price of the second home, it might be better to wait. However, if the purchase price of the second home is much less than the adjusted sales price of the first, you may not be able to postpone much of your gain. Therefore, you might be better off to take the exclusion when you sell the first home. (See IRS Publication 523, "Tax Information on Selling Your Home" and/or call Tele-Tax Tapes 551, 552 and 553.)

Adjustments to Income

FORM 1040A, LINES 15a–16; FORM 1040, LINES 24a–30; TELE-TAX TAPES 251 TO 254

Once you have figured your total income, you may "adjust" it downward with any of six major adjustments to arrive at adjusted gross income. The only adjustment to income that can be taken on Form 1040A is the deduction for contributions to an IRA. All other adjustments must be taken on Form 1040. You do not have to itemize to take these adjustments to income. Employee business expenses are no longer an adjustment to income (but they are an itemized deduction on Schedule A) except for certain performing artists and handicapped employees.

- *Individual Retirement Arrangements.* An IRA is a personal savings plan that lets you set aside money for your retirement. You may be able to deduct contributions you make to an IRA in whole, or in part, depending on your circumstances. Earnings and gains on your IRA generally are not taxed until they are distributed to you. Generally, you can contribute up to the lesser of your taxable compensation, or $2,000. If you (or your

spouse) were covered at any time during the year by an employer's retirement plan, your deduction may be limited. If your deduction is limited, you can still make nondeductible contributions up to the remaining amount of your contribution limit. If you file a joint return with your spouse (who did not work during the year), you may be eligible to contribute up to $2,250 into two separate IRAs (one for you and one for your spouse, a spousal IRA). You can divide the contribution between the two accounts in any way except that neither account can be credited with more than $2,000. See Publication 590 for more information.

If you were age 70½ or older by the end of 1990, you cannot deduct any contributions made to your IRA or treat them as nondeductible contributions.

- *Other adjustments.* All other adjustments must be claimed on the Form 1040. These other adjustments include: contributions to a Keogh Retirement Plan by self-employed persons; a percentage of the health insurance premium of a self-employed person; penalties paid due to premature withdrawal of funds from your time-savings deposits; one-half of self-employment tax shown on line 10 of Schedule SE; and alimony payments.

Standard Deduction

FORM 1040A, LINES 18a–19; FORM 1040, LINES 33a–34; IRS PUBLICATION 501, "EXEMPTIONS, STANDARD DEDUCTION, AND FILING INFORMATION," TELE-TAX TAPE 357

The standard deduction reduces the need for many taxpayers to itemize deductions. The standard deduction, which depends on your filing status (explained earlier) and whether you are 65 or over or blind, is not built into the Tax Table or Tax Rate Schedules but is figured separately.

If you are 65 or over or blind in 1990 you are entitled to a standard deduction amount which is more than the amount for taxpayers under 65 and not blind. You are considered 65 for the 1990 tax year if your 65th birthday was on or before January 1, 1991. You are considered blind for 1990 if you are blind on the last day of 1990. See your tax instruction booklet for more details.

Special rules. Your standard deduction is zero if your spouse itemizes deductions on a separate return, you are a dual-status or nonresident alien, or you have a short tax year. If you can be claimed as a dependent on another person's tax return, your standard deduction is limited.

Use one of the following charts. Choose the chart that best fits your personal situation.

STANDARD DEDUCTION CHART FOR MOST PEOPLE

DO NOT use this chart if you were 65 or older or blind OR if someone can claim you as a dependent.

If your filing status is:	Your standard deduction is:
Single	$3,250
Married filing joint return or Qualifying widow(er) with dependent child	5,450
Married filing separate return	2,725
Head of household	4,750

Standard Deduction Chart for People Age 65 or Older or Blind

If someone can claim you as a dependent, use the worksheet below, instead.

Enter the number from the box on line 33a of Form 1040 ▶ ☐

Caution: Do not use the number of exemptions from line 6e.

If your filing status is:	The number above is:	Your standard deduction is:
Single	1	$4,050
	2	4,850
Married filing joint return or Qualifying widow(er) with dependent child	1	6,100
	2	6,750
	3	7,400
	4	8,050
Married filing separate return	1	3,375
	2	4,025
	3	4,675
	4	5,325
Head of household	1	5,550
	2	6,350

Standard Deduction Worksheet for Dependents

Use this worksheet ONLY if someone can claim you as a dependent.

1. Enter your **earned income** (defined below). If none, enter 0 ..... 1. _____
2. Minimum amount 2. $500
3. Compare the amounts on lines 1 and 2. Enter the **larger** of the two amounts here ..... 3. _____
4. Enter on line 4 the amount shown below for your filing status:
   - Single, enter $3,250
   - Married filing a separate return, enter $2,725
   - Married filing a joint return or Qualifying widow(er) with dependent child, enter $5,450
   - Head of household, enter $4,750 ..... 4. _____
5. Standard deduction.

a. Compare the amounts on lines 3 and 4. Enter the **smaller** of the two amounts here. If under 65 and not blind, stop here and enter this amount on Form 1040, line 34. Otherwise, go to line 5b ..... 5a. _____

b. If 65 or older or blind, multiply $800 ($650 if married filing a joint or separate return, or qualifying widow(er) with dependent child) by the number on Form 1040, line 33a. Enter the result ..... 5b. _____

c. Add lines 5a and 5b. Enter the total here and on Form 1040, line 34 ..... 5c. _____

Earned income includes wages, salaries, tips, professional fees, and other compensation received for personal services you performed. It also includes any amount received as a scholarship that you must include in your income. Generally, your

earned income is the total of the amount(s) you reported on Form 1040, lines 7, 12, and 19, minus any deduction you claim on line 25.

Itemized Deductions

FORM 1040 ONLY, LINE 34, AND SCHEDULE A; TELE-TAX TAPE 301, "SHOULD I ITEMIZE?"

You generally have a choice between itemizing your deductions (such as medical expenses, taxes, interest, moving expenses, unreimbursed employee business expenses, and casualty losses) on Schedule A (Form 1040) or taking a standard deduction amount, whichever is more beneficial to you. You can further reduce your taxes if you can itemize, or list, deductible expenses which exceed your standard deduction amount. If you itemize deductions, you must use Form 1040.

To determine whether itemizing deductions is worthwhile for you, add together any 1990 expenses you had in the following major areas of deductibility: (a) medical and dental expenses; (b) income and property taxes paid to State and local governments; (c) certain interest paid on home mortgages and 10 percent of interest paid on automobile loans, personal loans and other credit accounts; (d) moving expenses; and (e) contributions to charitable organizations. If your total exceeds your standard deduction amount, you should itemize your deductions on Schedule A, Form 1040.

You will find there are other deductible items in addition to the major categories listed above. They are casualty and theft losses, and certain miscellaneous deductions, including employee business expenses. Generally, miscellaneous deductions are deductible only to the extent the total exceeds 2 percent of your adjusted gross income. You will also find that you can deduct medical expenses, including insurance premiums, only to the extent they exceed 7.5 percent of your adjusted gross income. You may deduct nonbusiness casualty and theft losses only to the extent each loss is more than $100 and to the extent that the total of all such losses as reduced exceed 10 percent of your adjusted gross income.

The Tele-Tax Tape list toward the back of your instruction booklet includes 13 pre-recorded tapes (numbers 302 to 314) on itemized deductions. In addition, the free publication list and order form on the back cover of your tax package contains references to a number of publications on specific deductible expenses.

Tax Computation

FORM 1040A, LINES 19–20; FORM 1040, LINES 37–40; TELE-TAX TAPES 351 to 358

Once you have claimed all your adjustments, deductions, and exemptions, you are left with a figure called "taxable income" from which you determine how much tax you owe. To find your tax, locate your taxable income in the Tax Tables in the back of your tax instruction booklet and match it with the column showing your filing status. For instance, if you have $20,000 in taxable income and your filing status is head of household, you find the line for taxable income of at least $20,000 but less than $20,050 and look under the column labeled "Head of a household" to find that your

tax is $3,004. You must use the Tax Tables unless your taxable income is $50,000 or more. In that case, you must use the Tax Rate Schedules.

Tax Credits

FORM 1040A, LINES 24–26; FORM 1040, LINE 41–46, 57, 60, AND 61; TELE-TAX TAPES 401 to 403

Tax credits directly reduce the tax you owe. The Earned Income Credit, the Credit for the Elderly or the Disabled, and the Credit for Child and Dependent Care Expenses may be claimed on either Form 1040A or Form 1040. All other credits must be taken on Form 1040.

- *Credit for the elderly or the disabled.* This credit may reduce your taxes by as much as $750 ($1,125 if married) if you are at least age 65 or if your are under 65 but retired due to permanent and total disability and you received a taxable disability pension in 1990.

  Even if you meet one of the above conditions, you generally cannot take the credit if you are:

  —Single and the amount on Form 1040, line 32 (Form 1040A, line 16), is $17,500 or more; or you received $5,000 or more of nontaxable Social Security or other nontaxable pensions.

  —Married filing a joint return, only one spouse is eligible for the credit, and the amount on Form 1040, line 32 (Form 1040A, line 16), is $20,000 or more; or you received $5,000 or more of nontaxable Social Security or other nontaxable pensions.

  —Married filing a joint return, both spouses are eligible for the credit, and the amount on Form 1040, line 32 (Form 1040A, line 16), is $25,000 or more; or you received $7,500 or more of nontaxable Social Security or other nontaxable pensions.

  —Married filing a separate return, you did not live with your spouse all year, and the amount on Form 1040, line 32 (Form 1040A, line 16), is $12,500 or more; or you received $3,750 or more of nontaxable Social Security or other nontaxable pensions.

  For more information, see Publication 524, "Credit for the Elderly or the Disabled," and/or call Tele-Tax Tape 403.

- *Credit for child and dependent care expenses.* If you paid someone to care for your disabled spouse, your child under age 13 (unless handicapped) or your disabled dependent so you (and your spouse, if married) could work or look for work, you may be able to claim a tax credit of up to $720 ($1,440 for two or more qualifying persons). The credit ranges from a maximum of 30 percent of expenses for taxpayers with adjusted gross incomes of up to $10,000, to a minimum of 20 percent for taxpayers with adjusted gross incomes above $28,000. The maximum amount of expenses used to compute the credit is $2,400 ($4,800 for two or more qualifying persons). Also, you must include the name, address, and taxpayer identification number (unless it is an exempt organization) of the care provider on your tax

return. (See IRS Publication 503, "Child and Dependent Care Credit," and Publication 926, "Employment Taxes for Household Employers," and/or call Tele-Tax Tapes 401 and 606.)

- *Earned income credit.* If you worked and had both earned income and adjusted gross income that were less than $20,264, and you had a child who lived with you in your main home in the U.S. for more than half the year (for all of 1990 if your filing status is qualifying widow(er) with dependent child), you may be able to claim an earned income credit. Your filing status must be married filing jointly, qualifying widow(er) with dependent child, or head of household. The maximum earned income credit is $953. The earned income credit, unlike other credits, can be paid to you as a "refund" even if you do not owe any taxes. Your employer can even pay you in advance for this credit. (See IRS Publication 596, "Earned Income Credit," and/or call Tele-Tax Tape 402.)

Other Taxes

FORM 1040 ONLY, LINES 48–53; TELE-TAX TAPES 352 AND 354

In addition to your regular income taxes, you could owe additional taxes in any of the other tax categories listed on the Form 1040. The two categories of most importance to older Americans are: (1) Social Security tax due on the net profits from self-employment; and (2) taxes on IRAs and retirement plans. The other taxes are Social Security tax on tip income, the alternative minimum tax, and a recapture of previously taken investment tax credits.

Refund/Amount You Owe

FORM 1040A, LINES 25–33; FORM 1040, LINES 54–67; TELE-TAX TAPES 453 AND 456

Once you have determined your final tax liability by subtracting out all your credits and adding in any other taxes, you have only one more step—to determine whether you owe the government or the government owes you. If your withholding and estimated tax payments plus any other payments exceed your tax liability, you are due a refund. If not, you should attach a check or money order for the total taxes you owe.

VII. PREPARING FOR NEXT YEAR

Estimated Tax and Withholding

IRS PUBLICATION 505, "TAX WITHHOLDING AND ESTIMATED TAX," TELE-TAX TAPES, 156, 459, AND 466

The Federal income tax system operates on a pay-as-you-go basis. Typically, taxes are withheld from wages, salaries and other forms of compensation including some retirement payments. If taxes are not withheld you are probably required to make quarterly payments to meet your estimated tax liability. Some examples of income from which income tax is not generally withheld are: inter-

est and dividends; self-employment; alimony; rental income; capital gains; and the taxable portion of Social Security benefits.

- *Estimated tax requirements.* If you expect that the "Amount You Owe" on your 1991 tax return will be $500 or more, and you expect the income tax withheld in 1991 will be less than 90 percent of the tax to be shown on your 1991 tax return and less than 100 percent of your 1990 tax liability, you should make estimated tax payments on or before April 15, June 15, September 15, and January 15, 1992.

  To calculate your estimated tax, add together your expected income tax, alternative minimum tax, and any Social Security self-employment tax. Next subtract anticipated income tax withholdings and tax credits. If you have income from which taxes are withheld and other income from which no taxes are withheld, you may be able to increase the withholding on the first income and eliminate the need to make quarterly payments. If your estimated payments and withholding total less than 90 percent of your tax liability, you may incur a penalty for underpayment of taxes. No penalty is assessed, however, if your estimated payments and withholding for 1991 equal or exceed your total tax liability for 1990.
- *Withholding on pensions and annuities.* Unless you choose not to have any withheld, income taxes generally will be withheld from the taxable pension and annuity payments you receive. This includes distributions from an IRA, profit-sharing plan, or a stock-bonus plan. If you receive such payments and failed to give the payer your current marital status and the number of allowances you can claim, taxes generally will be withheld as if you were married with the three allowances. Therefore, if you are single, too little tax will be withheld and you could owe additional taxes and possibly be subject to penalties. On the other hand, if you have several dependents and/or itemize deductions you may be paying more tax than necessary. Although you can get a refund for your excess withholding, the government generally does not pay you any interest on the money it holds.

  Use Form W-4P to inform the payor of your periodic pension or annuity of the proper number of allowances you can claim. You can even tell the payer not to deduct any taxes at all. If you are a U.S. citizen or resident alien whose residence address is outside the United States, the payer must withhold tax. However, it is up to you to make estimated tax payments or to increase the amount of withholding on other income to meet your tax obligations, if any.

Highlights for 1991

IRS Publication 553, "Highlights of 1990 Tax Changes," Tele-Tax Tape 452

Some of the tax changes that you should consider when you figure your income tax withholding or estimated tax for 1991 are discussed in this section. For information on other changes, see Publication 553, "Highlights of 1990 Tax Changes."

Personal exemption. For 1991, the personal exemption amount for you, your spouse, and each dependent has increased to $2,150.

Standard deductions: Individuals who are not dependents and who do not itemize deductions have an increased standard deduction for 1991. For 1991, the amounts for each filing status are as follows:

Married filing joint return and qualifying widow(er)	$5,700
Head of household	5,000
Single	3,400
Married filing separately	2,850

An additional standard deduction amount is allowed when the taxpayer is either age 65 or older or blind. For an unmarried individual (single or head of household), the amount is $850 ($1,700 if both 65 or older and blind). For a married individual (married filing joint, married filing separately, or qualifying widow(er) with dependent child), the amount is $650 ($1,300 if both 65 or older and blind) for each spouse who qualifies.

Personal interest. For 1991, no personal interest (such as interest on car loans or credit card balances for personal expenses) is deductible as an itemized deduction.

Cosmetic surgery. Unnecessary cosmetic surgery will not be an allowable medical deduction. It will be an allowable medical deduction if the cosmetic surgery or procedure is necessary to improve a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or a disfiguring disease.

Earned income credit. The earned income credit has been changed for 1991. There are three sections to the credit and the eligibility requirements have been modified. The maximum credit for each section is: (1) Basis Credit—for one child is $1,192 and for two children is $1,235; (2) Supplemental Young Child Credit is $357; and (3) Health Insurance Credit is $428.

New Tax Rates. The income tax rates are now 15%, 28%, and 31% instead of 15% and 28%.

Filing Requirements. The amount of gross income you may receive, if you are not a dependent, before you are required to file a return has increased as follows:

Single:	
Under age 65	$5,550
Age 65 or older	6,400
Married filing joint return:	
Both spouses under age 65	10,000
One spouse age 65 or older	10,650
Both spouses age 65 or older	11,300
Not living with spouse at the end of year (or on date spouse died)	2,150
Married filing separate return	2,150
Head of household:	
Under age 65	7,150
Age 65 or older	8,000
Qualifying widow(er):	
Under age 65	7,850
Age 65 or older	8,500

VIII. GIFT AND ESTATE TAXES

IRS Publication 448, "Federal Estate and Gift Taxes," Tele-Tax Tapes 355 and 356

You generally do not have to pay tax on any cash or property you receive as a gift or inheritance. Likewise, any gift or inheritance you pass on is generally tax-free to the recipient. If you make a gift of more than $10,000 to any one individual in the same year, you—but not the recipient—may be required to pay a gift tax.

For decedents who died during 1986, no Federal estate tax, nor any estate tax return, is due if the value of the decedent's gross estate is $500,000 or less. For decedents who died in 1987 and later, this amount increases to $600,000.

○